Office - Supreme Court, U.S.
FILED
MAY 18 1953
HAROLD B. WILLEY, Clerk

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

Same
Caption

No. 75

AMERICAN HARDWARE AND EQUIPMENT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOSEPH J. O'CONNELL, JR.,
Counsel for Petitioner.

INDEX

Subject Index

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement of Facts	3
Specification of Errors to be Urged	6
Reasons for Granting the Writ	6
I. In Denying the Deduction of Payments to the NTEA, the Decision of the Court of Appeals is in Conflict with Decisions of this Court and Decisions of Other Courts of Appeal	6
II. Amendments to the Regulation applied in Textile Mills Necessitate a Review of the Rule of That Case	14
III. The Decision of the Court of Appeals Involves a Fundamental Misconstruction of Section 23(a)(1)(A) of the Internal Revenue Code	21
IV. The Textile Mills Decision Should be Modified	23
Conclusion	24
Appendix "A"	25

Table of Cases Cited

Addressograph-Multigraph Corp., Par. 45,058 P-H Memo T. C. 12

Commissioner v. *Heininger*, 320 U. S. 467 7, 8, 19

Commissioner v. *Wanamaker*, 178 F. 2d 10, aff'g 11 T. C. 365 22

Deputy v. *Dupont*, 309 U. S. 448 7

Gesselshaft Fur Drahtlose Telegraphie M. B. H. v. *Brown*, 78 F. 2d 410 13

Hazelton v. *Sheckells*, 202 U. S. 71 13, 23

Helvering v. *Hampton*, 79 F. 2d 358 19

International-Great Northern Railroad Co., 24 B. T. A. 726 12

Page

Kansas City Southern Ry. Co., 22 B. T. A. 949..... 12
Lilly v. *Commissioner*, 343 U. S. 90.....7, 8, 11, 13, 14, 19, 20, 24
Leubuscher v. *Commissioner*, 54 F. 2d 998.....11, 14
Los Angeles & Salt Lake R. R. Co., 18 B. T. A. 168..11, 12
Lucas v. *Wofford*, 49 F. 2d 1027.....11, 14, 24
Marshall v. *B. & O. R. R. Co.*, 16 How. 314..... 12
Mead Corp. v. *Commissioner*, 116 F. 2d 187..... 21
Missouri Pacific Railroad Co., 22 B. T. A. 267..... 12
Robert S. LeSage, Par. 47,318, P-H Memo T. C..... 12
Roberts Dairy Co. v. *Commissioner*, 195 F. 2d 948, aff'g Par. 50,271 P-H Memo T. C..... 9
Rumely v. *U. S.*, 197 F. 2d 166, affirmed 73 Sup. Ct. 543 .....10, 11, 14, 24
Texas & P. Ry. Co. v. *U. S.*, 52 F. 2d 1040..... 12
Textile Mills Securities Corp. v. *Commissioner*, 314 U. S. 326.....7, 8, 10, 12, 13, 14, 15, 19, 20, 24
Trist v. *Child*, 21 Wall 441.....12, 13, 23
Welsh v. *Helvering*, 290 U. S. 111..... 7

STATUTES AND OTHER AUTHORITIES CITED

Statutes:
Revenue Act of 1935:
Sec. 102(c) 15
Revenue Act of 1938:
Sec. 23(a)(2) 15
Internal Revenue Code:
Sec. 23(a)(1) 2, 3, 6, 7, 16, 17, 18, 21, 22
Sec. 23(q)(2) 7, 16, 17, 18, 22
Sec. 101(6) 4
Sec. 101(7) 4
Federal Regulation of Lobbying Act:
2 U. S. C. A. Secs. 261-270..... 19

Miscellaneous:
Treasury Regulation 74:
Art. 262 .....7, 15, 17, 25
Treasury Regulation 111:
Sec. 29.23(a)-13 .....15, 17, 25
Sec. 29.23(q)-1 .....15, 17, 26

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1953

No. 75

AMERICAN HARDWARE AND EQUIPMENT COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, American Hardware and Equipment Company, prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Fourth Circuit in the above case.

Opinions Below

The opinion of the Tax Court of the United States (R. 22-24)[1] is reported in Par. 52,197 P-H T.C. Memo. The opinion of the United States Court of Appeals for the Fourth Circuit (R. 72-79) is reported in—F. 2d—(1953) P-H Par. 72,349.

[1] "R." designates the Transcript of Record from the Court below.

Jurisdiction

The judgment of the United States Court of Appeals was entered on February 17, 1953 (R. 79). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1), 62 Stat. 928.

Question Presented

During the taxable years ending July 31, 1947, and 1948, the petitioner was engaged in the wholesale hardware business in the states of North Carolina and South Carolina. During such years it made contributions to the National Tax Equality Association (hereinafter called "NTEA"), a non-profit organization, in the amounts of $1,800.00 and $1,500.00 respectively, to obtain assistance in meeting the competition of cooperatives engaged in the same business. The question presented is:

Whether the courts below erred in holding that these contributions were not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda activities or otherwise attempting to influence legislation.

Statute Involved

The statute involved is section 23(a)(1) of the Internal Revenue Code.

> "Sec. 23. DEDUCTIONS FROM GROSS INCOME.
>
> "In computing net income there shall be allowed as deductions:
>
> "(a) Expenses.
>
> "(1) Trade or business expenses.
>
> "(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.
>
> "(B) Corporate charitable contributions. No deduction shall be allowable under subparagraph

(A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *."

Statement of Facts

Reference to the Record discloses the following facts:

The taxpayer is a North Carolina corporation, engaged in the sale of hardware at wholesale in North and South Carolina. From the years 1934 and 1935, competition in this field became increasingly keen by reason of the growth of co-operative business organizations operating in its territory in a tax-free position, enabling such co-operatives to infringe upon the then-existing business of the taxpayer and to take over an increasing amount of the new business in the territory (R. 3). The competitive position of the co-operatives was strengthened by their tax-free status and enabled them to sell at a lower price and to offer certain "advantages" to the ultimate consumers, many of whom purchased through the co-operatives for the purpose of obtaining rebates or dividends made possible by the lower tax burden carried by the taxpayer's competitors. The taxpayer found itself in a competitive fight, not only to obtain new business, but even to maintain its then-position against odds which it felt to be discriminatory and unfair (R. 3).

It became necessary, in the opinion of the taxpayer's Board of Directors, to obtain information relating to the growth, mode and scope of operations, sources of supply, existing and contemplated outlets, financial structure, tax advantages and other data relating to this new type of competition (R. 6). Taxpayer's Directors considered the question of obtaining this necessary information at the lowest cost and determined to subscribe to the services of a business league known as the National Tax Equality Association, Inc. (R. 6).

The NTEA was organized in the State of Illinois as a non-profit organization and was ruled exempt by the U. S. Treasury Department under Section 101(6) of the Code as a scientific and educational association. By request of NTEA, this ruling was modified to exempt the association under Section 101(7) of the Code as a business league (R. 23). The purposes of NTEA as set out in its constitution and by-laws provided that the object of the corporation was to "conduct educational, scientific and research activities relative to disparities in Federal and State Tax Statutes and other laws and regulations affecting business and to disseminate such information to civic organizations and representatives of business affected thereby, to the public and to Federal and State Governments" (R. 5).

The taxpayer in the tax year 1947 made a contribution in the amount of $1,800.00, and in the tax year 1948 a contribution in the amount of $1,500.00 to NTEA for the purpose of obtaining the desired studies, data, and other information furnished by the NTEA and for the purpose of advising its clientele, incorporating the material into letters to its trade (R. 6), briefing its salesmen on the type of competition offered by the co-operatives and methods of combatting it (R. 6), and otherwise developing a sympathetic public opinion incident to maintaining and increasing its sales in competition with the co-operatives.

The taxpayer determined that it could obtain the necessary data through NTEA at less expense to itself than by maintaining its own research and tax staff (R. 9).

The petitioner benefited in developing a better relationship with its customers and with the ultimate consumer by utilizing the pamphlets and books obtained from NTEA (R. 8). The petitioner used the material furnished to carry its competitive story to the merchants from whom it purchased, to its wholesale accounts, and to the consumers, appealing to them and to the general pub-

lic to adopt a sympathetic attitude toward its problems in competition with the tax-free co-operatives and attempting to hold its customers and build its business goodwill (R. 8). The studies and pamphlets furnished the taxpayer by NTEA during the tax years in question made no mention of any objective of influencing legislation, nor did the NTEA call for members to write Congressman or intervene in pending legislative matters (R. 7).

Neither NTEA nor the taxpayer had a lobby in Washington nor did either attempt to approach Senators or Congressman to bring up any issue relating to changes in the tax laws (R. 10). NTEA merely sought to have its members work together to carry out its purposes as expressed in its Constitution and By-laws. The petitioner transposed information from pamphlets and books furnished by NTEA and forwarded such information to its customers (R. 11).

The taxpayer was not acquainted with the internal affairs of the NTEA, but was of the opinion that it operated from its Chicago headquarters rather than from any state organization in North Carolina or elsewhere. The taxpayer did not know the source of the material furnished it by NTEA and was not familiar with the identity of the individual research men or writers of such material.

From the time the petitioner became a member of the NTEA, it received bulletins and pamphlets in large numbers, which were of assistance in creating an atmosphere of goodwill within its trade territory and which were used for the purpose of appealing to the sense of fair play of the public and of its customers, present and potential, in order to increase its sales and profits (R. 6).

The Farmers Co-Operative Exchange, a co-operative operating in North Carolina, is in direct competition with the taxpayer (R. 17). It has had a phenomenal growth amounting to three or four times the growth experienced by the average corporation in the same field during the

same period (R. 17). The dollar volume of the purchasing co-operatives as shown by a report of the North Carolina Department of Tax Research directed to the General Assembly of North Carolina, indicated a growth within the nation from $190,000.00 in 1929-30 to $1,111,000.00 in 1946-47, or almost six thousand times (R. 18). The general business position of Farmers Co-Operatives Exchange had grown increasingly competitive and was particularly competitive in 1947 and 1948. The method used by the Farmers Co-Operative Exchange was to take over an existing business (R. 19). The rate of expansion of the Farmers Co-Operative Exchange in North Carolina was in excess of the rate of expansion by the ordinary merchant because of accumulated funds through profits derived from tax exemptions (R. 20).

Specification of Errors to be Urged

The Court of Appeals for the Fourth Circuit erred:

1. In holding that the petitioner's contributions were not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda or of otherwise attempting to influence legislation.

2. In affirming the decision of the Tax Court.

Reasons for Granting the Writ

I. In Denying the Deductions of Payments to the NTEA, the Decision of the Court of Appeals is in Conflict with Decisions of this Court and Decisions of other Courts of Appeal

Section 23(a)(1)(A) of the Internal Revenue Code provides that a taxpayer may deduct all "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". The Court

of Appeals did not question that the petitioner was engaged in a trade or business, or that its payments to NTEA were incurred in carrying on a trade or business. Nor did the Court deny that, in the usual sense of the terms, the payments were "ordinary" and "necessary" expenses in the conduct of the petitioner's business. *Cf. Welch* v. *Helvering*, 290 U. S. 111; *Deputy* v. *Dupont*, 308 U. S. 488; *Commissioner* v. *Heininger*, 320 U. S. 467; *Lilly* v. *Commissioner*, 343 U. S. 90.

The Court of Appeals, relying on the decision of this Court in *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, disallowed the deduction for payments made by the petitioner because, simply, the payments were "expended for lobbying purposes * * * or the exploitation of propaganda". In reaching its conclusion, the Court of Appeals quoted from the *Textile Mills* opinion in part as follows:

> "Contracts to spread such insidious influences through legislative halls have long been condemned" (314 U. S. 326, at p. 338).

Furthermore, the Court of Appeals pointed out that in the *Textile Mills* case the Supreme Court had specifically approved a regulation (Article 262 of Treasury Regulation 74) denying deductions for lobbying expenditures. Although the injunction against lobbying contained in the old regulation in the *Textile Mills* case has disappeared[2] from the current regulations under section 23(a)(1), it may be argued that the underlying rationale of the old regulation still persists in the law. Expenses for "insidious" activities, "condemned" by this Court as activi-

[2] See Point II of this discussion, pp. 14-21, *infra*. In the years involved in this proceeding, the regulation approved in the *Textile Mills* decision had been revised and was no longer applicable to section 23(a)(1). Therefore to the extent that the decision of the Court of Appeals rests upon an approved regulation, it has no foundation whatever. Nor does any provision of section 23(a)(1)(A) itself so much as hint at the denial of a deduction for lobbying expenditures. *Cf.* section 23(q)(2).

ties "to which the law gives no sanction", remain unacceptable as deductible items. 314 U. S. 326, at pp. 338-339. But that is merely to say that such expenditures violate the firmly established public policy which was the basis of the old regulation. This Court, which recently rejected the government's assertion of an unbridled public policy doctrine, continues to recognize that expenditures inimical to "sharply defined national or state policies" are not deductible. *Lilly* v. *Commissioner*, 343 U. S. 90, 97. See also *Commissioner* v. *Heininger*, 320 U. S. 467, 474.

Do all lobbying activities *per se*, or the uses of "propaganda" in any form, violate "sharply defined" public policies? If not—and this Court made no such holding in *Textile Mills*—then the Court of Appeals' decision below has no foundation whatever. The decision becomes simply one more instance in which the Court of Appeals would act as an arbiter of public morals and acceptable business conduct. The activities of the NTEA which were ascertained by the Court of Appeals were clearly not of the same kind as those condemned in the *Textile Mills* decision. The decision below, therefore, would improperly ignore the standard enunciated by this Court in *Lilly* v. *Commissioner, supra.*

What were the activities of the petitioner and the NTEA which outraged the Court of Appeals, and to which the language of the *Textile Mills* opinion—"insidious" and "condemned"—may be applied? The sparse findings of fact by the Tax Court indicate that the expenditures of the petitioner were not made as part of a contract to secure special legislation; that the NTEA received no compensation, contingent or otherwise, for its legislative services; that the activities of the NTEA were principally research and the public dissemination of information relative to disparities in the federal and state taxing statutes, with the ultimate objective of revising the federal tax structure.

These findings may fairly be amplified by the following findings of the Tax Court in *Roberts Dairy,* Par. 50,271 P-H Memo T.C., which the Tax Court and the Court of Appeals deemed controlling in the instant case:

> "NTEA did not engage directly in lobbying activities, had no congressmen on its mailing list and did not request to appear before congressional committees considering changes in the tax statutes. Officials of NTEA did, however, appear before the Ways and Means Committee of the House of Representatives in 1947 at the Committee's request. In March 1946, NTEA, in one of its bulletins, asserted that the inquiry by this Committee concerning tax-exempt businesses was a direct result of the energy given that issue by NTEA.
>
> "In an NTEA publication dated February 1, 1944, the program of NTEA was to be one of dissemination to its members as well as to trade papers, periodicals, and newspapers of information prepared by its research division dealing with unequal taxation. It would also sponsor programs by speakers representing NTEA. It proposed to maintain a Washington counselor to represent the association and its members before congressional committees and other governmental agencies, as well as before state legislatures and other state, county and municipal bodies wherever tax problems arose.
>
> • • •
>
> "On November 19, 1943, a bill was introduced in the House of Representatives which on February 25, 1944, was enacted as the Revenue Act of 1943. Section 117 of the Act required organizations exempt from tax to file information returns. Publicity of NTEA gave credit to NTEA for the inclusion of this section in the bill as a result of NTEA's fact finding and publicity having been successfully presented by its members to Congress."

The legislative activities of the NTEA were not carried on in private chambers and cloakrooms. These activities were not calculated to, and did not, corrupt the political institutions of the nation. They bore no resemblance to the field of activity discussed in *Textile Mills* and condemned at common law.

The NTEA is an association of people with similar views on taxation. It has worked to have these views accepted by the public generally and, through the weight of public opinion, recognized by the public's representatives in the legislature. The petitioner urges that this type of activity, far from undermining stated public policy, conforms to recognized and indeed essential practices under our form of government.

As the Court of Appeals for the District of Columbia has recently stated, in *Rumely* v. *United States,* 197 F. (2d) 166, at p. 175:

> "Congress has a *duty* to protect the free flow from the people of influence, encouragement, promotion and retardation of legislative matters. So Congress has the right to restrict lobbying as properly defined, since such lobbying may, unless controlled, impede the effectual exercise of the people's power. *But Congress has no authority to impede the exercise of these functions of and by the people.*" (Italics added.)

The *Rumely* decision was affirmed by the Supreme Court without dissent. 73 Sup. Ct. 543. Justices Douglas and Black, concurring, indicated that restraints or controls over the defendant's right to publicize the legislative views of his organization would violate the First Amendment to the Constitution.

The kind of authority which Congress lacks certainly cannot be appropriated indirectly by the respondent. And it would be difficult to imagine a more direct impediment to legitimate legislative or lobbying activity than a disallowance of expenditures for such activity incurred in the

course of a taxpayer's trade or business. As the concurring opinion in the *Rumely* case observed, "* * * no legal sanction is involved here. Congress has imposed no tax, established no board of censors, instituted no licensing system". 73 Sup. Ct. 543, at p. 551.

Other courts have considered the matter whether all lobbying necessarily violates public policy, and answered in a clear negative. Some of these decisions, prior to the decision of the Supreme Court in *Lilly* v. *Commissioner*, were rendered at a time when no limit to the public policy doctrine was recognized.

In *Lucas* v. *Wofford*, 49 F. (2) 1027 (5th Cir.), fees paid to an attorney in connection with legislation that affected the taxpayer's business were allowed as a deduction. The Court stated:

> "The attorney was employed not to secure the passage or defeat of any legislation, but represent, by argument in a public and legitimate manner, to the Governor and to the legislative committees the injurious effect the legislation first proposed would have upon the respondent's business. Neither what was agreed to be done nor what was certainly done constituted lobbying" (p. 1028).

In *Leubuscher* v. *Commissioner*, 54 F. (2d) 998, the Court of Appeals for the Second Circuit allowed an estate tax deduction for a bequest to an educational foundation whose sole purpose was to teach, expound, and propagate the form of taxation known as the single tax on land advocated by Henry George. Since the single tax could only be achieved by legislation, it was clear that the educational foundation sought a change in legislation as its ultimate objective.

In *Los Angeles and Salt Lake R. R.*, 18 B.T.A. 168, the Board of Tax Appeals allowed the deduction of a contribution to the Association of Railroad Executives, which was engaged in an extensive advertising and publicity

campaign to avert enactment of legislation unfavorable to railroads. The Board stated:

> "It is clear that the purpose of the advertising and publicity campaign conducted by the Association was to create a body of public opinion favorable to the railroads of the country, and to avert the enactment of legislation unfavorable or injurious to them. The campaign was made by carrying in the newspapers of the country a series of advertisements setting forth the services rendered by the railroads, the problems confronting them, and suggesting sound legislation and wise regulation" (p. 177).

See, to the same effect, *International-Great Northern Railroad Co.*, 24 B. T. A. 726, 739; *Missouri Pacific Railroad Co.*, 22 B. T. A. 267, 287; *Kansas City Southern Ry. Co.*, 22 B. T. A. 949, 963; *Texas and P. Ry. Co.* v. *U. S.*, 52 F. (2d) 1040 (Ct. Cls.).

Subsequent to the *Textile Mills* decision, the Tax Court in at least two instances continued to recognize that not all legislative or lobbying activity was evil. In *Addressograph-Multigraph Corp.*, Par. 45,058 P-H Memo T. C., the court upheld a contribution to the National Association of Manufacturers, an organization engaged in "expressions of attitude with respect to legislation or other public policies". On the authority of *Los Angeles and Salt Lake R. R. Co., supra,* the Tax Court stated that contributions to correct unsympathetic public opinion are ordinary and necessary business expenses. See also *Robert S. LeSage,* Par. 47,318 P-H Memo T. C.

Now just what are the "family of contracts to which the law gives no sanction" which was the area of justifiable application of the old regulation? There is a line of decisions cited in the *Textile Mills* case and in other cases decided before and after *Textile Mills,* which does find an "insidious" character to certain forms of lobbying. See *Marshall* v. *B. & O. R. R. Co.*, 16 How. 314; *Trist* v. *Child,*

21 Wall 441; *Gesellschaft fur Drahtlose Telegraphie M. B. H.* v. *Brown*, 78 F. (2d) 410 (D. C. Cir.); *Hazelton* v. *Sheckells*, 202 U. S. 71. However, these decisions do not produce a blanket condemnation of all lobbying and legislative activities. Rather, they find an evil in *contingent fee arrangements to accomplish particular legislative ends through "private" bills.* This kind of lobbying, essentially the operation of "five percenters", may truly tend to corrupt the legislative process. This Court long ago pointed out, "Where the avarice of the agent is inflamed by the hope of a reward contingent upon success, and to be graduated by a percentage upon the amount appropriated, the danger of tampering in its worst form is greatly increased." *Trist* v. *Child*, 21 Wall 441, at p. 452. In another case it pointed out, "In its inception the offer, however intended, necessarily invited and tended to induce improper soliciting, and it *intensified the inducement by the contingency of the reward*". *Hazelton* v. *Sheckells*, 202 U. S. 71, at p. 79 (italics added).

The *Textile Mills* case involved this type of lobbying activity. The arrangements in that case called for a contingent fee for services to secure the passage of a special bill releasing particular properties held by the Alien Property Custodian. The *Textile Mills* decision by no means stands for the proposition that all legislative activity in any form offends against the public interest and welfare. In the *Lilly* case, this Court indicated that the *Textile Mills* decision rested upon the fact that "*some* types of lobbying expenditures had long been condemned" (italics added). See *Lilly* v. *Commissioner*, 343 U. S. 90, 95.

It seems obvious that the legislative activities of the NTEA, intended to create a public opinion favorable to changes in the Internal Revenue Code and consisting otherwise of open appearances before the Congressional committees on taxation, in no way frustrated sharply defined public policies. These activities were far removed from contingent fee arrangements for obtaining *ad hoc*

laws favoring a particular individual. To the contrary, the legislative activities of the NTEA fall within the framework of very ordinary conduct carried on by business and labor organizations generally. To say that any appearances before Congressional committees defeat public policy is to maintain, tacitly, that the Congressional hearings themselves offend against the public interest.

Summing up this point of the petition, the decision of the Court of Appeals necessarily rests on public policy grounds. In view of the uncontroverted findings of the same Court with respect to NTEA's actual conduct, there is no basis for a determination that the conduct of the petitioner or the NTEA is of an outlawed species "to which the law gives no sanction". The decision below is fundamentally in conflict with *Lilly* v. *Commissioner, supra; Rumely* v. *United States, supra; Lucas* v. *Wofford, supra;* and *Leubuscher* v. *Commissioner, supra.* It also constitutes an unwarranted and erroneous extension of the *Textile Mills* decision to a totally different factual situation. This conflict involves an important question of law which this Court should resolve.

II. Amendments to the Regulation Applied in Textile Mills Necessitate a Review of the Rule of that Case.

As previously indicated, the *Textile Mills* decision turned on Treasury Regulation 74, Article 262, promulgated under the Revenue Act of 1928.[3] What has been overlooked completely by the Court below are the important changes in the applicable law and regulations since the taxable years involved in that case.

Without the support of a specific statute or regulation there is no warrant for disallowance of the deduction of any ordinary and necessary business expense except where public policy may be frustrated.

[3] See *Lilly* v. *Commissioner*, 343 U. S. 90: "In *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, this Court accepted an interpretation of that section [Section 23(a)(1)(A)] by a Treasury Regulation which disallowed the deduction of certain expenditures for lobbying purposes."

Treasury Regulation 74, Article 262 was a double purpose regulation. It covered *both* contributions to charitable organizations and non-charitable organizations and was construed to apply to deductions under both Section 23(n) and Section 23(a) of the Revenue Act of 1928. "Sums of money expended for lobbying purposes" were not deductible under that regulation regardless of which of the two sections the deduction was claimed under. Pursuant to certain statutory changes described below, Article 262 has now been split, between two provisions of the regulations—Regulation 111, Section 29.23(a)-13 and Section 29.23(q)-1. The prohibition against the deduction of lobbying expenses is now included only in Section 29.23(q)-1, and it is no longer applicable to questions arising under Section 23(a).

In discussing this contention the Court below declared it "clearly untenable" under the *Textile Mills* decision. This answer misses the point. The contention is directed at the state of the law pursuant to changes in the law and regulations *after* the taxable years involved in *Textile Mills*, and nothing said in *Textile Mills* could possibly have any bearing on the construction of a later-enacted statute and a later-promulgated regulation. In Section 102(c) of the Revenue Act of 1935, now Section 23(q)(2), it was provided for the first time that corporations as well as individuals could deduct contributions made to organizations organized exclusively for charitable, scientific, educational or similar purposes, with the exception of such organizations, a substantial portion of whose activites consisted of carrying on propaganda or attempting to influence legislation.

In the Revenue Act of 1938, Section 23(a) was amended to include a new Section 23(a)(2) (now Section 23(a)(1)(B):

> "(2) CORPORATE CHARITABLE CONTRIBUTIONS. No deductions shall be allowable under paragraph (1) to

a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *."

In the report of a Subcommittee of the House Ways and Means Committee this new provision was explained as follows:

"In 1935 the income-tax law was amended to provide a specific deduction for charitable and other contributions by corporations to an amount not exceeding 5 percent of the corporate net income. No similar provision appeared in the law in prior years; but with respect to such years the Board of Tax Appeals and Federal courts held, in various cases, that particular gifts to charitable, religious, and welfare organizations were deductible as business expenses. When the specific subdivision was inserted in 1935, no change was made in the subdivision allowing deductions for business expenses, probably because the *Congress believed that the new specific provision would necessarily be controlling in respect of contributions to the designated organizations.* In order to clarify the law, the subcommittee recommends (Recommendation No. 36) that the specific subsection relating to business expenses, section 23(a), be amended to provide expressly that no deduction shall be allowed to corporations thereunder for any contribution of a class with respect to which a deduction is allowed by section 23(q)." (75th Cong., 3d Sess., H. Rept. January 14, 1938, p. 48; italics added.)

The report makes it plain that section 23(q)(2) was intended to be controlling in respect of contributions to the type of organization listed in that section. *Contributions to other organizations as ordinary and necessary business expenses are controlled by section 23(a).* As

no lobbying limitation was written into Section 23(a) it would appear that Congress did not intend that limitation to apply to organizations not described in Section 23(q)(2). The NTEA is not an organization of the type described in Section 23(q)(2), not being exclusively charitable or educational in purpose. See § 101(6), (7).

This distinction between Section 23(a) and Section 23(q) has been reflected in revised regulations for the taxable years involved in this case. The language of old Regulation 74, Article 262, has been split between Regulation 111, Section 29.23(a)-13 and Regulation 111, Section 29.23(q)-1 (reproduced in part in the Appendix). The effect of this split can be readily observed. Section 29.23(a)-13 reads in part as follows (italics indicates identical language to Regulation 74, Article 262):

> "• • • Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. *For example, a street railway corporation may donate a sum of money to an organization* (of a class not referred to in section 23(q)) *intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.*"

Regulation 111, Section 29.23(q)-1, reads in part as follows (italics indicates identical language as in Regulation 74, Article 262):

> "A corporation may, subject to the limitations provided by Section 23(q), deduct from its gross income, contributions or gifts to organizations described in section 23(q). • • • Such deduction shall, to the extent

provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, * * * *. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. *Sums of money expended for lobbying purposes, the promotion or defeat of legislation the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.*"

Thus, instead of a single section covering the entire field of corporate donations and disallowing all donations made for lobbying purposes, the current regulation provides for two separate and mutually exclusive sections—only one of which prohibits the deduction of lobbying expenses.

It seems perfectly clear that this "split" in the regulation drew a new distinction between donations made as an ordinary and necessary expense of the taxpayer's business and donations made to organizations described in Section 23(q). As to the latter the prior rule remains in full force and effect—a contribution to an organization engaged in lobbying cannot be deducted. But where the payment is an expense of doing business and is not made to an organization described in Section 23(q), *there is no applicable Treasury regulation disallowing the deduction of such an expenditure merely on the grounds that it was expended for lobbying purposes.*

Obviously since Congress has acquiesced in this change in the regulations since 1938, it is the legislative intent that the provision prohibiting the deduction of lobbying expenses, while applying in the case of contributions to certain exempt charitable, educational and scientific organizations, does not apply to legitimate business expenses.

Therefore, as the deductibility of this class of ordinary and necessary expenditure is no longer specifically prohibited by regulation when claimed under Section 23(a)

(1)(A), it need only be shown that it is consistent with public policy as that term has been defined for tax purposes in the *Lilly* case.

The petitioner's conduct, even if held to be the equivalent of lobbying, which it was not, was honorable and without any taint of illegality or moral wrongdoing. There is abundant authority for the allowance of deductions even where both flagrant illegality and immorality are the cause of the expenditure. *Commissioner* v. *Heininger, supra; Helvering* v. *Hampton*, 79 F. (2d) 358. This Court should not sanction the purely arbitrary and unfair discrimination of the respondent against the class of expenditures involved in this case. With the amendment of the specific regulation which provided the basis of decision in the *Textile Mills* case, the last obstacle to the abolition of an anachronistic rule has been removed. No sensible argument exists for its perpetuation. Properly carried on, legislative representation of businessmen is a necessary and desirable activity in this day of ever-increasing contact between government and business. This petitioner does not present the case for the briber, the influence peddler and their ilk. Since the *Textile Mills* decision the Congress which is properly most concerned with the lobbying problem has passed effective legislation to control and regulate it. In the Federal Regulation of Lobbying Act (2 U. S. C. A. §§ 261-270) enacted August 2, 1946 the Congress provided for the registration of lobbyists. The Report to the Senate of the "Special Committee on the Organization of Congress" on this Act describes the various types of lobbyists to which the registration requirement applies:

> "There is a third class of * * * respectable representatives of business, professional and philanthropic organizations who come to Washington openly and frankly to express their views for or against

> legislation, many of whom serve a useful and perfectly legitimate purpose in expressing the views and interpretation of their employers with respect to legislation which concerns them * * *." (S. Rept. 1400, 79th Cong., 2d Sess., p. 27.)

A spokesman for the Committee presenting the bill on the floor of the House stated:

> "After all, government having moved so deeply into the whole business, economic, and social field that the many fine organizations which represent various economic interests would be almost remiss in their obligation if they failed to keep abreast of developments in the legislative field." (Cong. Rec., Vol. 92, Part 8, p. 10090.)

It can hardly be said that such activity belongs to the "family of contracts to which the law has given no sanction". The very requirement of registration implies not only sanction, but conditional approval.

The decision of this Court in the *Lilly* case provides a clear and workable test for the disallowance of expenditures, which although made in the ordinary course of business, are made for a purpose so repugnant to a federal or state policy that in good conscience they should not be deductible. It is submitted that this is the rule that would have been adopted by this Court in the *Textile Mills* case but for the existing regulation.

Accordingly, stripped of the specific regulation governing the *Textile Mills* case, and without compensating support from the amended regulation or the statute, the respondent can only rely on the "public policy" doctrine to sustain his current position and that doctrine, as delineated in the *Lilly* case, gives no support to the respondent's position.

III. The Decision of the Court of Appeals Involves a Fundamental Misconstruction of Section 23(a)(1)(A) of the Internal Revenue Code.

The Courts below have made a fundamental error in construction of the applicable statute, Section 23(a)(1)(A) of the Internal Revenue Code. On the evidence they found that the NTEA was engaged in lobbying activities but they were unable to make a similar finding with respect to the petitioner. On the basis of such a record the findings of the Tax Court do not even make out a *prima facie* case for the disallowance of the petitioner's claimed deduction under Section 23(a)(1)(A). The standard of deductibility set up by that section is plain—the expenses in question must be an ordinary and necessary business expense of the taxpayer claiming the deduction and incurred during the taxable year.

The taxpayer is entitled to have its deduction determined on the basis of its own acts, purposes and objectives and not on the basis of the acts, purposes or objectives of the recipient of the payment, particularly in the absence of a finding or any evidence that would impute the recipient's purposes to the petitioner. The Courts below failed to note this missing link in the evidence. Conceding *arguendo*, that all lobbying expenses are non-deductible and similarly conceding that the NTEA was engaged in lobbying, it does not follow as the conclusion to the syllogism that the petitioner's payment to NTEA is non-deductible. What is obviously lacking is a finding as to the purposes of the petitioner in making the contribution.

The gap is not to be sloughed over. Where subjective intent is an operative fact the Courts have refused to attribute the purposes of one taxable entity to another even where the relationship of parent and subsidiary exists between them. *Mead* v. *Commissioner*, 116 F. (2d) 187 (3rd Cir.); *Rodman Wanamaker Trust*, 11 T. C. 365, aff'd 178 F. (2d) 10.

This point is not addressed to a mere technical defect in the findings. The petitioner offered a good deal of evidence as to its purposes which the Tax Court did not include in its findings, and neither the Tax Court nor the Fourth Circuit considered it in their opinions. This evidence may be briefly summarized. The petitioner's President testified that its strongest competitor was a co-op, the Farmers Co-Operative Exchange (R. 2). The co-op undersold the petitioner (R. 3) and the petitioner regarded the co-op as a serious threat to its business (R. 4). The petitioner received pamphlets and books from the NTEA with a good deal of statistical and factual information about co-ops which petitioner used to advise and inform the retailers to whom it sold about the nature and extent of the co-op threat (R. 6). Petitioner received no material from NTEA urging any action to influence legislation (R. 7). To the best of petitioner's knowledge NTEA did not have a lobby in Washington during the taxable years involved (R. 10). Nobody in the petitioner's organization contacted the Congressmen or Senators from North Carolina in connection with tax legislation (R. 11-12). The NTEA put the petitioner in a position to explain to its customers the nature of the cooperative movement and its dangers (R. 8).

In short, to maintain its business the petitioner felt it necessary to get the facts about the co-operative movement and to marshall the arguments which would stem the alarming drift of its customers to the co-operative fold. The NTEA supplied this need.

The Courts below have placed the wrong entity on trial. While the NTEA's activities might well be conclusive of the question if a charitable deduction had been claimed under Section 23(q)(2),[4] they are far from conclusive when the deduction is claimed under Section 23(a)(1)(A).

[4] This case does not arise under Section 23(q)(2) where the statute clearly provides that corporations may deduct only such charitable contributions as are made to organizations which meet the qualifications set forth in that section.

The petitioner and the NTEA are two wholly separate entities for tax purposes.

IV. The Textile Mills Decision Should be Modified.

In the event this Court should decide that the *Textile Mills* decision is applicable to the petitioner's contribution, it is earnestly urged that consideration be given to a modification of the doctrine laid down in that case. Since the taxable year involved in *Textile Mills* federal and state governments have embarked on prodigious programs of regulation and taxation of business activity. The federal government, particularly, has moved deeply into virtually all fields of business activity. In enacting legislation of this kind the Congress must necessarily seek the advice and opinion of the members of the group to be affected. These groups must be alert to present their views in a forceful but legitimate manner. The prosperity and welfare of all business is now, more than ever, dependent on an ability to "live" with such regulation and taxation as may be adopted. It is manifestly unfair to restrict their legitimate activities in proposing or opposing legislation by denying to them a deduction for their expenses incurred thereby. That Congress believes that there is a real function for the legitimate lobbyist to perform is amply demonstrated by the legislative history of the Federal Regulation of Lobbying Act, previously discussed.

It is suggested that this Court modify the holding in the *Textile Mills* case to apply only to expenses incurred pursuant to lobbying arrangements which were condemned at common law. *Trist* v. *Child, supra; Hazelton* v. *Scheckells, supra.* The public interest will be adequately protected by a rule which permits the deduction of expenses incurred in legitimate educational, publicity and legislative activity.

Presentations of arguments to legislative bodies in a "public and legitimate" manner should not be the subject of special unfavorable tax treatment. *Lucas* v. *Wofford, supra.* The right of the people freely to communicate with and legitimately influence their elected representatives without penalty or impediment is a primary issue in this case. *Cf. Rumely* v. *U. S., supra.* The rule in this area as presently applied by the respondent, indiscriminately penalizes all varieties of legislative activity, whether or not such activity frustrates public policy or would tend to corrupt. This rule is inconsistent with the general doctrine set out in *Lilly* v. *Commissioner, supra.* This Court should conform the special rule of *Textile Mills* to the principle enunciated in the *Lilly* case.

Conclusion

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

JOSEPH J. O'CONNELL, JR.,
Counsel for Petitioner.

APPENDIX "A"

Treasury Regulation 74, Article 262:

"Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under section 23(n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertisting other than trade advertising, and contributions for campaign expenses, are not deductible from gross income."

Treasury Regulation 111, Section 29.23(a)-13:

"Corporate contributions.—No deduction is allowable under section 23(a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 per cent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

"The limitations provided in section 23(a)(1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23(q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars."

Treasury Regulation 111, Section 29.23(q)-1:

"Contributions or gifts by corporations.—A corporation may, subject to the limitations provided by section 23(q), deduct from its gross income contributions or gifts to organizations described in section 23(q), except in computing net income for taxable years beginning before January 1, 1944, contributions or gifts to organizations organized and operated exclusively for veterans' rehabilitation services, or posts or organizations of war veterans, or auxiliary units of, or trusts or foundations for, any such posts or

organizations are not deductible unless such contributions qualify as deductions under section 23(q) prior to its amendment by section 114 of the Revenue Act of 1943. See section 29.22(b)(4)-1 for definition of 'political subdivision'. Where payment is made in a taxable year beginning before January 1, 1949, the charitable deduction prescribed is allowable to corporations even though the gifts or contributions are used outside of the United States or its possessions. Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of leglislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income. * * *"